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Equity Joint Ventures with the People's Republic of China: A Puzzle in Politics, Law, and Tradition

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I. INTRODUCTION

Attracting foreign investment through equity joint ventures has become a priority of the People's Republic of China (China). Western investors responded with cautious interest during the evolution of joint venture policy from 1979 to 1986. Some investors praise China's westernization in policy and goals, while others note high costs and low returns. Little comparative information on joint venture productivity exists, however, because most venture contracts have been signed since 1984.¹

Available information on the productivity of joint ventures in China needs review and analysis for two reasons. First, businesses in record numbers are signing venture contracts despite the unmeasured risks.² Some ventures may face failure from management mistakes and political blunders that investors could have predicted by using the experiences now available as guides. Second, current joint venturers are tiring of China's practical and policy-based impediments to venture production and profits. Some investors are threatening to pull out, and the first defection may prompt a wave of withdrawals.³

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1. As of Spring 1981, China had approved only 24 joint ventures. Chew-LaFitte, *The Resolution of Transnational Commercial Disputes in the People's Republic of China: A Guide for U.S. Practitioners*, 8 YALE J. WORLD PUB. ORD. 236, 247 (1982). Foreign economists estimate that no more than 750 joint ventures exist today, most of which are tiny textile and electronic assembly ventures with partners from Hong Kong or Macao. Wall St. J., June 6, 1986, at 28, col. 2.

2. The People's Republic of China Government claims 220 active ventures in coastal cities. Asian Wall St. J. Weekly, Feb. 11, 1985, at 11, col. 1.

3. See Wall St. J., *supra* note 1, at 28, col. 2.

A reassessment of equity joint ventures requires consideration of China's policy statement in order to discern their significance to Western relations, China's practical capabilities in venture production and management, and joint venture experiences as a testing ground for these policies and capabilities. This Article will discuss these issues as they might be encountered by an investor entering into a venture with a Chinese partner and will consider the feasibility of modern China as a venture site, the cultural climate in which the joint venture must operate, and the structure required for a successful venture.

II. WESTERN HOPES AND CHINESE POLICIES

China re-entered world trade relatively recently. In 1975 the People's Congress responded to leader Chou En-lai by adopting a new foreign trade policy.⁴ China undertook foreign trade relations to pursue her goal of the "Four Modernizations": to become as capable in agriculture, industry, national defense, and science as the world's great powers.⁵ In 1979 the Congress, led by Zhou's successor Deng Ziaoping, issued the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (Joint Venture Law) and made the joint equity venture a permissible form of foreign business relationship.⁶ To counter foreign investors' objections that the basic Joint Venture Law provided inadequate guidance and protection, the Congress added tax regulations,⁷ labor regulations,⁸ and trademark and patent laws.⁹ In September 1983 the Ministry of Foreign Economic Relations and Trade

4. Alford & Birenbaum, *Ventures in the China Trade: An Analysis of China's Emerging Legal Framework for the Regulation of Foreign Investment*, 3 NW. J. INT'L L. & BUS., 56, 66-67 (1981).

5. *Id.* at 67. The Four Modernizations should be complete in 1990. *See also PRC's Seventh Plan Means Tight Times in 1986-87, Easing as Decade Wears On*, BUS. ASIA, Apr. 28, 1986, at 130-31.

6. *See* Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment [Joint Venture Law] (1979), *trans. in* Shen Shiao-Ming, *China's New Law on Joint Ventures Using Chinese and Foreign Investment*, 34 SW. L.J. 1183, 1191 (1981).

7. The Income Tax Law of the People's Republic of China Concerning Foreign Enterprises (1981); The Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises (1982), *trans. in* 1 CHU, MOSER & NEE, *COMMERCIAL, BUSINESS, & TRADE LAW: THE PRC* 41-66 (1982).

8. Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment [Joint Venture Labor Regulations] (1980), *trans. in* E. ASIAN EXECUTIVE REP., Oct. 15, 1980, at 25.

9. Trademark Law of the People's Republic of China (1982), [2 Bus. Reg.] China Laws for Foreign Business (CCH Austl. Ltd.) ¶ 11-500 (Mar. 14, 1987); Patent Law of the People's Republic of China (1984), [2 Bus. Reg.] China Laws for Foreign Business (CCH Austl. Ltd.) ¶ 11-600 (Mar. 14, 1987).

(MOFERT) released regulations which were intended to clarify many restrictions and obligations.¹⁰

On October 22, 1985, Deng's government took the next decisive step to promote economic vitality. The People's Congress issued a program of economic decentralization.¹¹ The program's reforms gradually remove subsidies while raising workers' pay, ultimately allowing prices to respond to market conditions.¹² The new policy also transfers decision-making authority from officials to industry managers,¹³ rewards superior work performance with higher pay,¹⁴ and permits some private entrepreneurial activity.¹⁵ In addition, middle-level managers gain a measure of authority to enter into foreign contracts.¹⁶

Proponents hope the reform will create a free market to ease the Government's burden of industry subsidies and allow Chinese industry to gain technical capability rapidly from Western industry. The resultant improved goods, produced in volume, could generate sufficient foreign exchange to offset expenditures for foreign technology and materials, thereby maintaining a positive Chinese trade balance. The goal is to raise the standard of living through domestic sales of the improved goods.¹⁷

To serve these ends, the policy favors joint ventures that minimize foreign exchange.¹⁸ Favored joint venture proposals produce products that can compete in world markets, apply advanced technology to restructure China's existing enterprises, use new technology and equipment in China, and augment foreign exchange income by means other

10. Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment [Joint Venture Regulation] (1983), *trans. in BEIJING REV.*, Oct. 10, 1983, supplement. See generally Note, *The People's Republic of China—1983 Joint Venture Implementing Regulations—The Supplement of Detail to Attract Foreign Investment*, 15 GA. J. INT'L & COMP. L. 389 (1985).

11. Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure [October Reforms] (1984). See *PRC Economic Reforms Will Shift Reliance to Market Focus*, BUS. ASIA, Oct. 26, 1984, at 337 [hereinafter *PRC Economic Reforms*].

12. *PRC Economic Reforms*, *supra* note 11, at 337-38; *What MCNs Should Expect From China's Reforms: Benefits and Snags*, BUS. INT'L., Nov. 2, 1984, at 345-46.

13. *PRC Economic Reforms*, *supra* note 12, at 337; *What MFNs Should Expect From China's Reforms: Benefits and Snags*, *supra* note 12, at 346.

14. *PRC Economic Reforms*, *supra* note 12, at 337; *What MFNs Should Expect From China's Reforms: Benefits and Snags*, *supra* note 12, at 346.

15. See Reeder, *A Small Study of a Big Market in the People's Republic of China—The "Free Market" System*, COLUM. J. WORLD BUS., Winter 1983, at 74, 75.

16. See Bennett, *The Party Resists Change In China's Factories*, WALL ST. J., Feb. 6, 1985, at 30, col. 1.

17. See generally China, *The New Revolution*, Miami Herald, Mar. 28-30, 1985, at 1A, col. 3.

18. See Wassermann, *China's Expanding Trade*, 19 J. WORLD TRADE L. 542, 543 (1985).

than the export of produce.¹⁹

The reforms appear strikingly successful because of a rare convergence of events. High expectations led Chinese consumers to spend record amounts in 1984,²⁰ while industrial output rose 13.6 percent.²¹ Many Chinese attributed the new prosperity to the reforms.²² Prompted by their optimism, many Chinese undertook entrepreneurial activity.²³ The people and the Government generally are motivated to tolerate continued change.²⁴

Given this optimistic atmosphere, investors have many good reasons to consider joint venture agreements with Chinese partners. The domestic market is the world's largest.²⁵ Yet, there is little competition from Western quality products, which cannot be sold legally in China, or from Chinese goods, which are scarce and inferior in quality to Western products.

The land offers a variety of raw materials for industrial supply, including oil, minerals, and coal.²⁶ Labor costs appear comparable to underdeveloped Asian and South American countries.²⁷ In contrast to many of these countries, China boasts a rich history and culture which promise to generate a steady flow of foreign tourist income.²⁸ The new market appears ripe for development. Indeed, many feel the race for a China market share will be won within the next several years.²⁹

Not all recent political indicators are positive, however. Many investors hesitate to rely on China's official position.³⁰ The reforms may prove unreliable because they include an interrelated package of simulta-

19. Shen Shiao-Ming, *supra* note 6, at 1186.

20. In 1984 the consumer sector, producing televisions, tape recorders, electric fans, washing machines, and refrigerators, sold between 50% and 190% of 1983 sales. *Asian Wall St. J. Weekly*, Jan. 21, 1985, at 4, col. 1.

21. *Id.* Industrial growth is booming in 1986. *See PRC's Seventh Plan Means Tight Times in 1986-87, Easing as Decade Wears On*, *supra* note 5, at 130.

22. *Asian Wall St. J. Weekly*, Dec. 17, 1984, at 3, col. 1.

23. *Id.*

24. *Id.* at 2, col. 3. *But see* Sterba, *Peking's Streets Teem With Merchants Again As State Loosens Reins*, *Wall St. J.*, June 16, 1986, at 1, col. 1.

25. *See* Comment, *Legal and Economic Considerations on Doing Business in the People's Republic of China*, 12 CAL. W. INT'L L.J. 353, 381 (1982) (China has one billion consumers).

26. Alford & Birenbaum, *supra* note 4, at 95-96.

27. *Id.* at 96. Even with the wage surcharge required by the Joint Venture Law, overall costs remain competitive with Asian and African sites.

28. *Id.* at 95.

29. *Export License Labyrinth: A Chinese Puzzle for High Tech Sales to PRC*, *BUS. INT'L*, Sept. 7, 1984, at 281, 285.

30. *See Asian Wall St. J. Weekly*, *supra* note 2, at 12, col. 1.

neous changes in economics and ideology.³¹ Failure in one area may undermine all reform. For instance, a crop failure resulting in famine could cause an abrupt retreat into isolationism. Likewise, an increase of corruption among officials could generate a counter-reform movement to expel the negative force of foreign influence.³²

Forces of economic failure and political opposition already have produced cycles of failure and retreat. Between 1975 and 1978 Beijing's determination and popular enthusiasm for an earlier decentralization campaign encouraged lower officials to conclude many foreign trade contracts. Beijing initially failed to recognize the volume of purchases involved. By 1979, however, China's commitment to imports clearly exceeded its export capabilities and meager foreign exchange reserves.³³ The overextension violated China's determination to invite contacts while maintaining economic autonomy.³⁴ As a result, Beijing cancelled the contracts or delayed work commencement indefinitely.³⁵

The Government thereafter restructured its goals to accommodate the economy's weak points, particularly the lack of capital and infrastructure. The Four Modernizations were redefined to emphasize high technology and light industry.³⁶ An end to retrenchment was declared in July 1982.³⁷

This economic resolution unfortunately failed to clear the way for reform. Marxist-Maoist conservatives continued to complain of profiteering, bribery, corruption, and widespread moral laxity stimulated by decentralization of authority.³⁸ In late 1983 newly affluent peasants suffered harassment and beatings by reactionaries who accused them of

31. Asian Wall St. J. Weekly, *supra* note 22, at 2, col. 1.

32. *See id.* at 2, col. 2.

33. *See Chinese Bull in China Shop*, ECONOMIST, Feb. 21, 1981, at 78.

34. Note, *An Analysis of Chinese Contractual Policy and Practice*, 27 WAYNE L. REV. 1229, 1235 (1981) (citing Holtzmann, *Resolving Disputes in U.S.-China Trade*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 84 (H. Holtzmann, ed. 1976). *See also* Chew-LaFitte, *supra* note 1, at 249-52; Lussenberg, *Joint Venture Investment in the People's Republic of China: A Continuing Challenge*, 63 CAN. BAR REV. 545, 554 (1985).

35. However, some investors assert that programs essential to the Four Modernizations continued as planned in 1979-81. Moga, *Making Foreign Things Serve China: A Western Licensor's Guide to the Chinese Market*, 28 ST. LOUIS U.L.J. 771, 782-83 (1984). A notable casualty in these cancellations was phase II of the Baoshan Steel Joint Venture. *See* Comment, "Far from the Tiger's Mouth": *Present Practice and Future Prospects for the Settlement of Foreign Commercial Disputes in the People's Republic of China*, 3 J.L. & COM. 115, 118-19 (1983).

36. *See* Moga, *supra* note 35, at 779-80.

37. Wall St. J., July 27, 1982, at 4, col. 1.

38. Asian Wall St. J. Weekly, *supra* note 22, at 2, col. 2.

"spiritual pollution."³⁹ Deng officially deplored the dissidents' values and disgraced the leaders.⁴⁰ Marxist-Maoist proponents await an opportunity to take advantage of a wave of popular dissatisfaction forcing a return to conservatism.⁴¹

Cycles of initiative and retreat will undoubtedly recur, since the reforms require painful transitions. Hoarding, bankruptcies, inflation, and windfall profits as a result of price deregulation have created shortages.⁴² The popular enthusiasm supporting reform may erode as many peasant farmers are forced from their traditional lifestyles into jobs in light industry and mechanized farming.⁴³ Some officials and urban Chinese involved in businesses have succumbed to profiteering and graft.⁴⁴ Deng acknowledged the vitality of objections to reform at the Communist Party Conference of September 1985, denouncing the "injustice . . . inherent in capitalism."⁴⁵ The Government yet manages to maintain its generally favorable stance toward foreign business.⁴⁶

Despite the level of commitment to joint ventures voiced by the Chinese and the interest of Western investors, impediments to rapid growth remain. China's rudimentary manufacturing, transport, and financial infrastructures pose problems. Some disgruntled investors assert that Chinese attitudes and policies block real progress;⁴⁷ the Chinese claim Western investors are impatient because they fail to understand China.⁴⁸ However, new understanding may not engender investor patience or profits. To assess the feasibility of a joint venture, an investor must understand China's deep-rooted reservations about Western thought and practice.

39. Asian Wall St. J. Weekly, *supra* note 22, at 2, cols. 3, 4.

40. See *id.* Analysts speculate that Deng manipulated conservative activism to create an opportunity to suppress it and affirm his policies. *Id.*

41. *Id.* at cols. 2, 3.

42. See, e.g., Wall St. J., Feb. 22, 1985, at 34, col. 1.

43. China's goal is to urbanize 40% of its peasants by the year 2000. Asian Wall St. J. Weekly, *supra* note 2, at 12, col. 1.

44. Asian Wall St. J. Weekly, *supra* note 22, at 3, col. 1. See also Wall St. J., *supra* note 42, at 34, col. 2 (example of grain company employee who received a death sentence for scalping grain coupons).

45. *China's Party Conference: Victory for Reform— But . . .*, BUS. ASIA, Sept. 27, 1985, at 307, 308 [hereinafter *China's Party Conference*].

46. Wall St. J., Mar. 20, 1985, at 36, col. 1 (every area except foreign trade and investment under scrutiny for "unhealthy tendencies").

47. Wall St. J., *supra* note 1, at 28, col. 2.

48. *Id.*

III. THE JOINT VENTURE'S CULTURAL CONTEXT

Tempting as the belief is that China is inviting foreign cultures to lead it through an industrial revolution to Western capitalism, the reality is that China consciously values its 3000 years of cultural heritage.⁴⁹ China sees little it considers worthwhile in past Western culture and much it deems undesirable.⁵⁰

A. Interaction with the West

From the first unsought and unwelcome European contacts, China limited the foreign presence on its soil. China's emperor restricted foreign merchants to short-term visits for declared purposes in designated coastal trading enclaves.⁵¹ No foreigner received permission to do business directly with the Government, producers, or consumers.⁵²

European demands ultimately eroded the Chinese policy. In 1750 Great Britain forced the Chinese to open five cities for trade.⁵³ Wrestling political and judicial control from local hands, Europeans exploited coastal areas with virtual immunity from suit.⁵⁴ In the revolution of 1949, a Russian "advisor" elite replaced the Europeans.⁵⁵ All of China was divided into spheres of foreign influence by 1960.⁵⁶ Only since the Russians were ejected in 1960 has China been free of privileged foreigners.⁵⁷

B. Business and Trade Customs

Even supposing it did not have a deep-seated mistrust of foreigners, China has no need for a Western model of private industry. Its own model, the Chinese trading firm, differs jarringly from Western capitalism. The trading firm represented the basic entity of Chinese commercial activity from the 1600s to 1949, and still maintains legitimacy.⁵⁸ The traditional Chinese firm illustrates the roles and relationships the Chinese consider appropriate for business.

49. See Alford & Birenbaum, *supra* note 4, at 61-64.

50. See Van Ness, *Don't Count on Changing the Chinese*, Asian Wall St. J. Weekly, Jan. 21, 1985, at 10, col. 1.

51. Alford & Birenbaum, *supra* note 4, at 61.

52. *Id.* at 61.

53. *Id.* at 61-62.

54. See *id.* at 61-63.

55. *Id.* at 62-63.

56. *Id.* at 64.

57. *Id.*

58. See generally Chan, *The Original Structure of the Traditional Chinese Firm and its Modern Reform*, BUS. HIST. REV., Summer 1982, at 218.

Such firms traditionally were not producers of goods. Instead, firms distributed goods originally produced by imperial monopolies or by cottage industries.⁵⁹ The large firm which traded in goods produced by a royal monopoly existed by government grant and for the benefit of its patron, a government official. That is, it existed primarily to provide revenues for the Government.⁶⁰ Under this system, relations with customers and colleagues were less important than the firm's relationship with the government patron.⁶¹ This model, with its government affiliation, underlies modern Chinese business entities. Despite decentralization, a Western investor cannot assume that a Chinese partner acts independently.

Chinese firms seek long-term associations, consistent with the general Chinese view towards business relations.⁶² Dealings that Western businesspersons consider to be arm's-length transactions generally take place under the cloak of friendship. The Chinese concept of "friendship" traditionally encompasses a permanent relationship of obligations.⁶³ To cultivate these obligations, the Chinese use a variety of stratagems to manipulate feelings of favor, guilt, or dependence.⁶⁴ For example, modern high-level officials may write personal notes, send gifts, and host banquets, creating the environment of goodwill that the Chinese favor as a basis for agreement.⁶⁵

C. The Chinese View of Authority and Reward

A description of the structure of the traditional trading firm also reveals the traditional employer-employee relationship. It consisted of a central absolute authority, the merchant-owner, and semi-autonomous, paid managers located in branch units who trained as apprentices in the

59. See Myers, *Hidden Goals in Chinese Industrialization: Lessons from Early Modernization Attempts*, COLUM. J. WORLD BUS., Winter 1982, at 74, 75.

60. *Id.*

61. *Id.* at 75-76. Chinese firms rejected a producing role although the government encouraged it in a late nineteenth century effort to generate Western levels of productivity. The short-lived firms were called *kuan-tu shang-pan* enterprises. *Id.* at 74.

62. Comment, *supra* note 25, at 382. An expatriate Chinese-American who has returned to China on invitation to revitalize his family's factory comments, "[A]ll business is done here by a word and a handshake." National Geographic: Four Americans in China (PBS television broadcast, Feb. 13, 1985).

63. Asian Wall St. J. Weekly, *supra* note 20, at 1, col. 2.

64. *Id.* The term "friendship" even serves for feelings resulting from any mutually beneficial relationship with an aspect of trust. See, e.g., Asian Wall St. J. Weekly, *supra* note 20, at 18, col. 4.

65. *Id.* at 18, col. 4.

owner's main establishment.⁶⁶ Owners traditionally valued their managers as much for personal loyalty as for business ability.⁶⁷

Managers had authority and responsibility subject only to owner veto. They received a salary that was supplemented by a fixed share of ten to forty percent of net profits.⁶⁸ The manager in turn hired clerks and apprentices for his branch who were from his own or the owner's home province, choosing on the basis of personal recommendations.⁶⁹ Clerks' wages were low, but they also received supplementary profit percentage bonuses.⁷⁰ None of these bonuses could be converted to ownership shares as in Western business.⁷¹

D. The Chinese View of the Group and the Individual

Knowledge of the firm's structure also provides some insight into the Chinese individual's role in a business entity. All staff except the senior manager lived on the premises in order to work sixteen-hour days, seven days per week. The clerks' families were forbidden to move to the town where the work was located.⁷² Instead, each employee returned to his home province for one to two months once a year.⁷³ All workers in this system expected the work experience to dominate their lives and valued the intense involvement with a secure workplace "family." The existing factory system closely resembles the traditional Chinese firm, providing housing, child care, and meals, and often requires employees to work a twelve-hour day.⁷⁴

Recent studies provide further insight into the Chinese view of the individual and the group. Self-actualization for a Chinese worker is defined in terms of service to the community.⁷⁵ American assumptions—individual freedom, accountability, and reward—appear only in recent

66. See Chan, *supra* note 58, at 219-20. See generally Myers, *supra* note 59, at 74-75.

67. See Chan, *supra* note 58, at 219-20. This pattern is often followed today. One successful firm uses teams of two managers: one hired for talent, one for loyalty. *Id.* at 226. The manager often has a written agreement. See *id.* at 220. He is liable for losses from negligence or dishonesty. *Id.*

68. *Id.* at 220. The bonus is called *jen-li*, or "human labor share". *Id.*

69. *Id.* at 221.

70. *Id.* at 220-21.

71. *Id.* at 226.

72. *Id.* at 221.

73. *Id.* at 220-21.

74. *Id.* at 220.

75. Nevis, *Cultural Assumptions and Productivity: The United States and China*, SLOAN MGMT. REV. (M.I.T.), Spring, 1983, at 17, 21.

ideology statements.⁷⁶ An inventory of Chinese priorities shows such self-interest does not dominate business dealings.

Conformity to ideology is to the Chinese worker top priority.⁷⁷ Following such ideology, workers value (in descending order) bonuses and wages, personal ambition or aspiration, a happy family life, honorable title, expertise, and fame. Below these ranks concern with promotion.⁷⁸

These values underlie a society in which a valuable member subjugates personal attainment to group goals. The individual's reward is a sense of belonging. In accord with these values, a Chinese worker will reject individual praise because effective recognition emphasizes the accomplishment itself as a benefit to the group. Bonus pay is more likely to bring greater satisfaction than promotion, which invites confusion for the worker and jealousy from others.⁷⁹

Undeniably, these values are slowly shifting. The Chinese recognize weaknesses in such strong group identification, just as Western firms have recognized the harmful effects of ruthless self-promotion among workers and have tried to engender a stronger group image to promote cooperation.⁸⁰ For the foreseeable future, the standard American management model which allows workers equal opportunity to compete for unlimited rewards cannot be relied upon to satisfy needs among Chinese board members or factory line workers.⁸¹

E. The Chinese View of Law, Contract, and Bureaucracy

A Western investor may better understand Chinese dispute resolution by envisioning a system utilizing a continuum of methods of increasing formality and coercion: friendly consultation, then friendly consultation with outside help, nonbinding conciliation, arbitration, and finally, litigation. This view in practice so confuses Westerners that scholars have written at length on the Chinese dispute resolution system.⁸²

76. See *id.* at 19-22. See, e.g., Reeder, *supra* note 15, at 74 (enthusiasm for entrepreneurial activity in the People's Markets).

77. See Nevis, *supra* note 75, at 23.

78. *Id.*

79. See *id.* at 19-22.

80. See *id.* at 19, 23.

81. See *id.* at 17.

82. See Alford & Birenbaum, *supra* note 4, at 92-93; Note, *supra* note 34, at 1238. See generally Pettit, *Dispute Resolution in the People's Republic of China*, ARB. J., Nov. 1, 1984, at 3, 4; Li, *Reflections on the Current Drive Toward Greater Legalization in China*, 10 GA. J. INT'L & COMP. L. 221 (1980); Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CALIF. L. REV. 1284 (1967).

The Chinese abhor compulsion or coercion and do not rely upon it. Instead, Chinese culture orders society by standards called *li*.⁸³ Good people aspire to conform to Confucian *li*; no honest person behaves so badly that *fa*, or law, limits action. In addition to *li*, Buddhist-Taoist doctrine requires the Chinese to choose compromise over conflict.⁸⁴ As a result, the Chinese ideally resolve all disputes by understanding the needs of the other party, taking their own needs into consideration, and agreeing on an equitable solution.⁸⁵ Third party arbitration and litigation are anathema to orderly society, and signal hostility and rejection.

Western society, by contrast, traditionally relies on the law, only recently incorporating into its justice system a continuum of cooperative, informal dispute resolution methods akin to that of China.⁸⁶ Businesses in the West, however, have always cooperated and compromised to preserve mutually profitable long-term relations. An investor may better understand the Chinese system by comparing Western business practices that seek amicable solutions without recourse to compulsion.

Chinese mistrust of law inevitably colors the perception of lawyers. Few trained lawyers existed in China in 1979, and despite rhetoric favoring their education and practice, only a slightly larger number practice today.⁸⁷ They act only in limited capacities and are not advocates in the Western sense.⁸⁸ The Chinese lawyer traditionally has acted as a "seeker of truth," a mediator, whose first duty was to serve the state.⁸⁹

Just as the Chinese eschew reliance on written law, they also avoid using detailed contracts to govern business relationships. Custom and relationship traditionally assured smooth business dealings. When confronted with sharp Western dealings, Chinese merchants appropriated a two-page, standard form contract drafted to protect only their own interests.⁹⁰ Since 1949, the commercial contract has also served as a planning instrument for the state.⁹¹ In such cases, the contract is a statement of optimistic intention, not of binding obligation. In light of historical protectionism, recent contract legislation has created much confusion.⁹²

83. Note, *supra* note 34, at 1230-31.

84. *Id.* at 1231.

85. *Id.* at 1239. E.g., if Chinese managers fail to agree, government ministers negotiate, adopting the same positions as their subordinates. *Id.*

86. See, e.g., Ingriselli, *Resolving Contract Disputes With Chinese Firms*, Nat'l L. J., Sept. 10, 1984, at 20, col. 1 (commercial disputes resolved by private mediation firm).

87. See Lussenberg, *supra* note 34, at 548-50.

88. *Id.* at 549.

89. See Comment, *supra* note 25, at 357.

90. Note, *supra* note 34, at 1241, 1252-58.

91. Comment, *supra* note 25, at 385.

92. *New Chinese Contract Law*, BUS. ASIA, April 5, 1985, at 108.

Use of an executory contract to guarantee individual acts is alien to Chinese relationships.

Influences from Chinese tradition have shaped practical and ideological realities in China and continue to affect business relationships at both policy and personal levels. They also shape the physical environment with which the investor must cope by isolating China from Western ideas and from world commerce. The equity joint venture that recognizes and accommodates these influences has the greatest potential for overcoming the obstacles to success.

IV. STRUCTURING THE JOINT VENTURE FOR THE PEOPLE'S REPUBLIC OF CHINA

A. Making Contact with Potential Partners

The Chinese prefer to do business with personal friends. If such a relationship does not exist, it must be built before business begins.

The Chinese market may be accessed only by invitation.⁹³ Expatriate Hong Kong merchants made the first investments in 1979 by relying on family ties to make sound contacts.⁹⁴ Many Hong Kong firms now specialize in matching Western investors with venture partners.⁹⁵ Some Chinese nationals living abroad also promote personal contacts intended to develop into business relationships by a chain of referrals. Other private individuals approach potential investors with claims of government or business influence, primarily with low-level officials or middle-level managers with recently acquired contracting authority.⁹⁶

The foreign investor should thoroughly investigate any contact offer. The contact individual should have both sound personal relationships with active Chinese officials and businessmen and a business reputation for credibility.⁹⁷ In addition, the foreign investor should require an un-

93. Asian Wall St. J. Weekly, Aug. 28, 1984, at 2, col. 1.

94. See Kraar, *A Little Touch of Capitalism*, FORTUNE, April 18, 1983, at 1221. Hong Kong entrepreneurs continue to make a large volume of China trade deals by cultivating a circle of influential business contacts. Most are simple "suitcase companies" reselling goods into the China market. Nearly half their attempted transactions fail. Asian Wall St. J. Weekly, Nov. 12, 1984, at 6, col. 1.

95. *Mating PRC Land, Labor With Hong Kong Shipping To Help Open Market*, BUS. ASIA, Mar. 2, 1984, at 69.

96. *What Firms Can Expect As Economic Reforms Take Root in China*, BUS. ASIA, Jan. 4, 1985, at 9, 10. But see Asian Wall St. J. Weekly, *supra* note 94, at 6, col. 1 (urgent phone calls, whispered negotiations, and secret meetings "like the Wild West").

97. Arnold, *With a Client in China*, 87 COM. L.J., Apr. 1982, at 170, 171.

conditional introduction to avoid unnecessary complications.⁹⁸

A handful of major United States law firms have attained expertise in China trade since 1979.⁹⁹ These firms may provide excellent contacts. However, an investor should bear in mind the negative attitudes that Chinese harbor toward lawyers, and utilize the attorney for referrals and behind-the-scenes advice only.¹⁰⁰ A number of large firms have added Chinese-speaking associates since 1983, traveled to China, and recruited Chinese interns.¹⁰¹ These firms, however, may not offer expertise and lack the long-term relationships most helpful to an investor. Neither do the new Chinese law firms offer a reliable service, since their lawyers generally do not act as client advocates.¹⁰²

The China International Trust and Investment Corporation (CITIC), a government bureau established in October 1979, can provide contacts with potential partners.¹⁰³ An investor whose objectives coincide with government goals may benefit from CITIC guidance, since the Chinese partner chosen by the government agency may be favored by other approving agencies. Trade shows and business symposia have also provided many initial contacts.¹⁰⁴

After identifying a partner, but before starting negotiations, an investor has an opportunity to establish the basis for both a sound relationship and productive negotiations. Experienced foreign traders urge an investor to provide internal materials describing the company and public assessments from trade journals.¹⁰⁵ Chinese officials and managers verify advance information and assess preliminary proposals.¹⁰⁶

Since the decentralization reforms, identifying a capable partner has become far more complicated. Formerly, an investor was invited to visit China to see a single potential partner, a government ministry represen-

98. *What Firms Can Expect As Economic Reforms Take Root in China*, *supra* note 96, at 10.

99. Ingriselli, *supra* note 86, at 20, col. 1.

100. *See supra* notes 82-89 and accompanying text.

101. *See* Ingriselli, *supra* note 86, at 20, col. 1.

102. *See id.*

103. *See* Alford & Birenbaum, *supra* note 4, at 83-84; Chew-Lafitte, *supra* note 1, at 246.

104. *E.g.*, Bishop Graphics began a relationship which grew into a joint venture at the Aug. 1980 Trade Show in Hong Kong. *See Electronics Joint Venture in PRC Shenzhen Zone Sets a Good Example*, *BUS. ASIA*, May 4, 1984, at 137 [hereinafter *Electronics Joint Venture*]. China's Hong Kong seminar in Nov. 1984 sought investors for SEZs and Hainan. *Asian Wall St. J. Weekly*, Nov. 19, 1984, at 8, col. 2.

105. *Negotiating in Japan: A BI Checklist for Successful Bargaining*, *BUS. INT'L*, Nov. 23, 1984, at 370 (on prenegotiations with Japanese firms).

106. Arnold, *supra* note 97, at 174.

tative.¹⁰⁷ Factories now may have contracting authority, subject to unacknowledged government patronage and veto power.¹⁰⁸ Investors advise a visiting investor to accept each factory tour offered, then to initiate negotiations with three possible manager-partners.¹⁰⁹

B. Assessing a Partner's Capabilities

Two attributes identify a strong partner: a solid government patron and adequate financial resources.¹¹⁰ To verify a claim of high connections in government, the Western investor typically holds a banquet and invites the government patron, to determine whether the managers can produce a high level official.¹¹¹ Because they are unable to rely on Western-style credit information banks to determine financial resources, investors simply ask detailed questions. They report that the Chinese give reliable responses to questions about capital.¹¹²

Legal limits on contracting authority serve as general guides in structuring a venture. For example, all Special Economic Zones (SEZs) can approve contracts valued at five million dollars or less.¹¹³ The City of Chonquin has authority to bypass provincial approval to directly obtain final authority from Beijing.¹¹⁴ The new China Textile Industrial Corporation for Foreign Economic and Technical Cooperation and the China Textile Machinery Corporation also can obtain direct Beijing approval. Any factory in a Special Economic Zone theoretically has authority to form a contract valued in excess of the average value of existing joint ventures or (approximately two million dollars).¹¹⁵

In fact, Chinese managers are still reluctant to exercise their decision-making power. Most managers lack experience in buying materials to supplement state raw materials allotment.¹¹⁶ Party officials who distribute state allotments have greater expertise and often pressure manag-

107. Wall St. J., April 25, 1985, at 34, col. 4.

108. *Id.*

109. *Id.*

110. See *supra* notes 60-65 and accompanying text.

111. Wall St. J., *supra* note 107, at 34, col. 4.

112. *Id.* A Chinese partner often lacks the supply and marketing information the investor needs, but the investor should persevere in getting answers to all questions. *What to Watch While Planning a China Joint Venture*, BUS. ASIA, Sept. 20, 1985, at 299 [hereinafter *What to Watch*].

113. *Incentives for Investors in China's 14 Cities*, BUS. ASIA, Aug. 10, 1984, at 251-52 [hereinafter *Incentives for Investors*]. Tianjin and Shanghai can approve US\$30 million contracts; and Dalian can approve US\$10 million, as can provincial governments. *Id.*

114. Wall St. J., Sept. 5, 1984, at 36, col. 1.

115. Asian Wall St. J. Weekly, Dec. 3, 1984, at 17, col. 3.

116. Comment, *supra* note 25, at 374.

ers to share their new authority to determine factory production levels. Through the Workers' and Party Committees, these officials may criticize the manager's ideology for making an independent decision.¹¹⁷ In line with political caution and tradition, the Chinese are likely to make such decisions by consultation with many colleagues over a period of time.¹¹⁸

Managers, nevertheless, do make contracts pursuant to their new authority. The investor should avoid relying on promises the manager cannot fulfill. For example, because another concurrent contract may supply substantially similar technology, any payment for technology transfer logically must be suspect until the Government approves it.¹¹⁹ A Chinese manager cannot know he will be unable to fulfill the promise until the Government vetoes it.¹²⁰

C. Forming a Basis for a Successful Relationship

An investor may to some extent counter mistrust and conform to Chinese relationship patterns by cultivating a strong, consistent image and emphasizing fairness and friendship.¹²¹ To build this image a negotiating party should establish a personal, but not familiar, relationship with each member of the Chinese team.¹²² Initial contacts are likely to consist of small talk, itinerary planning, and polite statements of hopes for successful negotiation. Foreign guests making frivolous remarks or references to politics risk appearing disrespectful.¹²³ Any display of anger, even for tactical purposes, conveys an impression of unreliability.¹²⁴

Ostentatious presentations have failed to impress high officials nego-

117. Arnold, *supra* note 97, at 171. See also Asian Wall St. J. Weekly, *supra* note 115, at 17, col. 3.

118. Arnold, *supra* note 97, at 171.

119. Asian Wall St. J. Weekly, Oct. 22, 1984, at 6, col. 1.

120. *Id.* at 6, col. 2. Western investors become confused by the Chinese concept of government-business interdependence, and expect to rely on government type benefits while retaining private enterprise independence. *Id.*

121. See *supra* notes 49-55 and accompanying text. Western business misunderstands China's long memory. One negotiator mistakenly refers to a "historical relationship of trust and confidence." Arnold, *supra* note 97, at 175.

122. See *Negotiating in Japan: A BI Checklist for Successful Bargaining*, *supra* note 105, at 371. The checklist also advises the following: 1) do not assume the negotiator with the best command of English is the most important member; instead, address the whole team; 2) use full names and maintain a formal posture; 3) allow silences; the team may be considering an important point; 4) if a question is met with evasion, consider why and rephrase it to avoid the sticking point. *Id.*

123. Comment, *supra* note 25, at 384.

124. See *id.* However, companies have forced breakthroughs after weeks of negotiations without progress by threatening to go home. *Id.*

tiating early joint ventures; however, an investor may reassess the most effective presentation style for mid-level managers. The most acceptable style eschews boasting and understates individual accomplishments as mere duties beneficial to the group.¹²⁵ An effective presentation conveys an impression of the company's extremely effective cooperative effort, without praising personal qualities of any individual.

At events with mixed business and social purposes, the Chinese may be uncertain about the desired level of involvement with foreign guests. Lengthy private conversations or visits to a manager's home may expose a Chinese contact to private or government censure. Nevertheless, Western products have been popular in China since 1985 and a foreign guest should expect ambivalent curiosity.

A foreign visitor should avoid any inference of bribery. Bureaucratic corruption has been the target of protesters' letters and posters since Deng allowed limited public dissent. To curtail a growing trend, a 1980 regulation restricts acceptance of foreigners' gifts by Chinese officials.¹²⁶ The negotiator who broaches the subject implies his partner is dishonest and ideologically unsound.¹²⁷

D. Choosing Time, Place, and Strategy for Negotiation

An effective negotiating strategy identifies Chinese wants and needs and develops proposals that match such interests with those of the foreign investor.¹²⁸ Many failures result from miscommunication of proposals. A team that stands a good chance of clear communication of ideas and terms ideally includes both a hired neutral interpreter who is experienced in business transactions¹²⁹ and a member familiar with Chinese business customs, philosophy, and politics.¹³⁰ Frequently, one individual fills both roles. Such a "China hand" may be either a corporate associate or an outsider.

To form a basis for verbal communication, an investor should put the company's position into writing as soon as possible. The most useful initial proposals state common ground first, saving major points of contention until the parties have built an environment of agreement.¹³¹

125. See *supra* notes 73-79 and accompanying text.

126. Alford & Birenbaum, *supra* note 4, at 92 (citing State Council Decision on Not Giving or Receiving Gifts in Foreign Affairs Activities).

127. Comment, *supra* note 25, at 384.

128. Alford & Birenbaum, *supra* note 4, at 96.

129. *Negotiating in Japan: A BI Checklist for Successful Bargaining*, *supra* note 105, at 371.

130. Arnold, *supra* note 97, at 171.

131. See, e.g., *id.* at 175.

Before discussing terms, the Chinese team will seek every technical detail the investor will divulge. A foreign investor can protect the company's negotiating position by preparing a plan to release technical information to satisfy demand. The disclosure should be tied to the progress of negotiating talks, and should identify matters to be withheld until the parties complete the agreement.¹³²

Virtually all final contract discussions take place near the intended joint venture site. The Chinese partner uses existing meeting rooms or public rooms in the hotel chosen for the foreign guest. The number and duration of meetings vary greatly. In general, Chinese teams prefer lengthy discussions to develop the relationship.¹³³ If the parties have an ongoing relationship, however, the contract may be finalized within days.¹³⁴

Investors find Chinese negotiators to be patient, persistent, and adept at bargaining for advantageous terms.¹³⁵ They are quick to label an offer "noncompetitive" with other similar proposals. However, they actually are unlikely to hold the "Dutch auction" that the comparison of proposals implies.¹³⁶ Having established an environment for understanding and agreement and bearing in mind Chinese goals and negotiation customs, the negotiator can focus on the joint venture contract.

E. Drafting the Contract

The Chinese are placing greater reliance on contracts as trade interaction becomes more complex. However, contracts still are used primarily to regulate foreign performance. The traditional Chinese aversion to detailed contract terms remains and can only be minimized by creating an environment of trust and good communication. The foreign investor who does business in the Chinese manner—without a written document—undertakes considerable risks. Chinese law fills few gaps left by

132. The manager of the China Department of the Chartered Bank observes that the Chinese have no concept of time as money. Kraar, *supra* note 94, at 128. See generally *What to Watch*, *supra* note 112, at 299.

133. But see *Electronics Joint Venture*, *supra* note 104, at 137 (citing example of Bishop Graphics, a California firm, which exported to China from 1979 to 1983, then negotiated a joint venture in three days to upgrade an existing Shenzhen factory). Without prior relationship, the minimum on record may be three months. *Id.* at 137-38; *Selling the China Market: It Doesn't Always Take*, BUS. INT'L., Feb. 17, 1984, at 68-69 (Hart non-electric dishwashers) [hereinafter *Selling the China Market*].

134. Comment, *supra* note 25, at 384, 385 (citing *China's Narrow Door to the West*, FOR-TUNE, Mar. 26, 1979, at 64). The company may wish to withhold some information until the contract receives government approval.

135. *Id.* at 382.

136. Comment, *supra* note 25, at 383.

the parties,¹³⁷ and a general statement of purpose and means leaves unanticipated problems to be resolved without clear guidelines.¹³⁸

A detailed contract greatly improves the likelihood of joint venture success by providing the law of the transaction.¹³⁹ Chinese custom dictates adherence to the literal interpretation of the document, without recourse to extrinsic evidence.¹⁴⁰ Admittedly, even extreme care may fail to fill all gaps without introducing unintended ambiguity, but the negotiator should document agreement on all major negotiated points and identify contingency plans.

F. Dealing with Governmental Bureaucracy

Extensive bureaucracy has guided Chinese life for hundreds of years.¹⁴¹ The decentralization reforms may shift power to a larger number of officials, but are unlikely to affect the bureaucracy's pervasive influence. A single Ministry of Foreign Trade supervises, negotiates, and licenses most business through the State Council regardless of the partner's identity. It also controls customs and funds the Chinese Foreign Trade Corporation, a partner in many foreign trade transactions.¹⁴²

Joint venture licensing and registration may sorely try a foreign investor's determination. Even a highly desirable joint venture may wait three months for approval.¹⁴³ Though the Joint Venture Law authorizes broad self-determination powers,¹⁴⁴ the central, provincial, and local governments retain informal controls to protect their arenas of responsibility.¹⁴⁵ To add to the confusion, these government branches do not customarily coordinate their actions or share information.¹⁴⁶

Some simplified bureaucratic procedures have been implemented in

137. Comment, *supra* note 25, at 385. See also Alford & Birenbaum, *supra* note 4, at 101.

138. Alford & Birenbaum, *supra* note 4, at 101.

139. Note, *supra* note 34, at 1242.

140. Comment, *supra* note 25, at 385. However, the Chinese in some instances have ignored the custom of strict adherence to contract. *Id.* at 1245 n.143. See also Note, *Foreign Investment in the People's Republic of China: Compensation Trade, Joint Ventures, Industrial Property Protection and Dispute Settlement*, 10 GA. J. INT'L. & COMP. L. 233, 253 n.42 (1983).

141. See Alford & Birenbaum, *supra* note 4, at 83-84.

142. Note, *supra* note 34, at 1236.

143. *JVs in China: Details of AMC's Big Jeep-Making Pact*, BUS. ASIA, June 10, 1983, at 180 [hereinafter *JVs in China*].

144. Joint Venture Law art. 6.

145. Alford & Birenbaum, *supra* note 4, at 82.

146. *Id.* at 83. For example, a joint venture to introduce modern electroplating technology waited for secondary approvals because its Chinese partner, the ministry controlling most of the materials, did not also control bulk chemicals. *US Firm's Deal Signals Widening PRC Market for JV Products*, BUS. ASIA, Mar. 23, 1984, at 89, 90 [hereinafter *U.S. Firm's Deal*].

SEZs, and may come into broader use if favored by the Government.¹⁴⁷ Beijing recognizes that bureaucracy impedes business development, and encourages local governments to relinquish a degree of control.¹⁴⁸ The approval system may become simpler as authorities share techniques for streamlining without losing control of foreign contracts.¹⁴⁹

G. Resolving Disputes

Methods for dispute resolution are appropriately addressed at the outset, before the venture contract is concluded. To choose among available procedures, the investor needs to understand the Chinese justice system well enough to avoid formal litigation and to satisfy a partner's sense of fair treatment, while resolving the difficulty as efficiently as possible.

The Joint Venture Law requires joint venture boards to settle important matters by friendly negotiations.¹⁵⁰ Such friendly negotiation of disputes has all the difficulties of the precontract negotiations—differing assumptions about time frame, appropriate subjects, and appropriate procedures.¹⁵¹ An ongoing friendly relationship assists in reaching agreement, but in the context of dispute each party must deal with disappointed expectations. The joint venture contract should anticipate these impediments by specifying the steps to be taken in negotiation and by setting a reasonable time frame relative to the urgency of resolution. It should also reserve to the parties the right to call for nonbinding mediation at any point.

Nonbinding mediation by a third party may provide a solution that eluded the partners in private negotiation without damaging the relationship. Any neutral party may mediate, but the procedures to be used should be agreed upon in advance to facilitate effective talks.¹⁵² The Foreign Economic and Trade Arbitration Committee (FETAC), an arm of the China Council for Promotion of International Trade (CCPIT), provides such mediation and other negotiating assistance.¹⁵³ On a written

147. See e.g., Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 3 (Canton moving all foreign trade ministry offices into one building).

148. See *id.* (projects requiring a dozen department approvals, resulting in indefinite delays).

149. *Id.*

150. Joint Venture Law art. 14.

151. See *supra* notes 121-36 and accompanying text.

152. See Comment, *supra* note 35, at 123.

153. *Id.* at 120. FETAC consists of 15 to 21 members whose occupations range from trade officials and economists to industrialists, transportation experts, insurance agents and international lawyers. Commission membership is a part-time responsibility. Not all members are located in Beijing. Routine work is, therefore, performed by the Legal Affairs Department of the CCPIT which has a full-time staff of thirty to forty persons. *Id.* at 123.

request by one or both parties, FETAC conducts fact finding, asks parties to submit their views in writing, and reviews documentary evidence.¹⁵⁴ Principles guiding FETAC include respect for the contract, the desire that each party understand the other's view, noncoercive proceedings, and respect for the law.¹⁵⁵ FETAC may abide by the choice of law specified in the joint venture contract. Upon completing its fact finding, FETAC indicates the strengths and weaknesses of the parties' positions and requests reconsideration in order to settle. If the parties continue to disagree, FETAC will repeat the process. Mediation is usually completed or terminated in about six months.¹⁵⁶

Because FETAC bases its decisions on governmental policies, an investor may prefer an international arbitrator if the contract allows this option. Such arbitrators conduct talks at neutral sites outside China.¹⁵⁷ Fully half of twenty-nine trade contracts surveyed called for talks conducted by such mediators,¹⁵⁸ with Stockholm the negotiation site apparently preferred by the Chinese.¹⁵⁹ However, contract legislation effective July 1, 1985, may limit the choices of law and sites available to joint ventures.¹⁶⁰ Whichever site is chosen, the parties may include the following terms in the venture contract: place of arbitration; arbitral institution to conduct proceedings; procedural rules; arbitral tribunal (selection method and umpire); choice of law; finality of award and mechanism of enforcement; judicial enforcement of arbitration clause; and other terms as applicable (for example, allocation of costs, language, notification and discovery procedures, and performance of contract during arbitration).¹⁶¹

Careful arbitration may prevent the ruin of a business relationship since the Chinese undeniably accept the trend to arbitrate international business disputes. The Chinese Government authorized arbitration centers in Beijing, Shanghai, Tianjin, and Dalian in September 1980, and plans others.¹⁶² Hong Kong lawyers plan to establish a nonprofit arbitra-

154. *Id.* at 120-21. This procedure resembles new United States mediation techniques involving written statement of position, fact finding, review of evidence and witnesses. United States mediators deal with parties separately to preserve parties' cases for trial. Nat'l L.J., Mar. 4, 1985, at 24.

155. See Comment, *supra* note 35, at 120-21; Chew-LaFitte, *supra* note 1, at 252.

156. *Id.* at 121-22.

157. See *id.* at 136.

158. *Id.* Possible arbitrators include the American Arbitration Association, the International Chamber of Commerce, and the Stockholm Chamber of Commerce. *Id.* at 134.

159. Comment, *supra* note 35, at 132.

160. *New Chinese Contract Law*, *supra* note 92, at 108.

161. Chew-LaFitte, *supra* note 1, at 275. See also Comment, *supra* note 35, at 135-36.

162. Comment, *supra* note 35, at 128.

tion center, which may provide a satisfactory forum for joint venture partners.¹⁶³

If litigation in the Chinese courts becomes unavoidable, the Legal Counsel Office of CCPIT provides some advice.¹⁶⁴ A claimant may also hire counsel, but the lawyer must be Chinese.¹⁶⁵ The new Chinese law firms offer their services to such foreign claimants.¹⁶⁶

To avoid litigation a foreign investor should approach all matters on which a partner disagrees as areas for negotiation and compromise. Because the Chinese negotiate over long periods, any time limits should be stated positively as goals at the outset. If the partners cannot agree, then an informal offer of assistance and advice to give the negotiations new life possesses the lowest risk of offense. Finally, if no greater loss will result from ending the relationship than arises from the existing stalemate, a foreign partner should carefully choose the forum and the remedy to minimize loss. To ensure the greatest chance of resolution, the joint venture structure should give each party more to gain by resolving than by prolonging disputes.¹⁶⁷

H. Establishing Duration and Plans for Termination

Anticipating an end to China's need for foreign involvement, the Government limited the life spans of ventures in some industries. For example, the investors must turn over large urban hotels to Chinese partners within ten to twenty years.¹⁶⁸ In other industries, China anticipates slower development. For example, the City of Dalian, which specializes in metallurgy and precision instruments, may approve ventures of up to fifty years' duration.¹⁶⁹

The Joint Venture Law requires the contract period to reflect the goals of the partners.¹⁷⁰ However, China may approve early termination if the business suffers losses, one party breaches, or performance becomes impossible.¹⁷¹ The Government promises protection in such circum-

163. Asian Wall St. J. Weekly, *supra* note 115, at 14, col. 3.

164. Comment, *supra* note 25, at 356. The Government passed the Organic Law for the People's Courts in 1979. By late 1981, the People's Courts included over 1000 economic courts. Comment, *supra* note 35, at 139-40. Some feel the law, encouraged by Deng, results from the Gang of Four abuses of individuals and institutions. Li, *supra* note 82, at 227. Such a view may imply the trend to resort to litigation is reactionary and temporary.

165. Comment, *supra* note 35, at 139-40.

166. See Lubman, *supra* note 82, at 1328.

167. Pettit, *supra* note 82, at 13.

168. Asian Wall St. J. Weekly, Jan. 14, 1985, at 17, col. 1.

169. Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 3.

170. Joint Venture Law art. 12.

171. Joint Venture Law art. 13.

stances for "all lawful rights and interests of foreign participants," including "resources invested" and "profits due," but it retains control of premature dissolutions, especially in instances where the contract is silent.¹⁷² Specific venture contract provisions anticipating likely causes for failure and with specific plans for termination may limit this type of government intervention.¹⁷³ In any case, risk of such intervention increases when the venture provides no more technical advances. The investor may anticipate discrimination after that time.

A successful venture undeniably must generate some profit within a reasonable time. Lack of profit has become a major complaint of current investors.¹⁷⁴ Some businesses have planned only projects that can recoup an investment within five years.¹⁷⁵ Few joint ventures are able to produce profits so quickly.

I. Choosing Board Members

The Joint Venture Law provides guidelines for the composition and function of the joint venture company board of directors reflecting the Chinese preference for negotiations and consensus.¹⁷⁶ The partners need not appoint members in proportion to their investment shares. The chair must be appointed by the Chinese participant, and one or two vice chairs by the foreign partners.¹⁷⁷ Important decisions must be reached by consultation based on the principles of equality and mutual benefit.¹⁷⁸

With such broad guidelines, patterns of interaction on joint venture boards have proved elusive. Representation tends to be proportional to investment.¹⁷⁹ Even-numbered boards may consist in equal shares of Chinese and foreign appointments, despite the risk of deadlock.¹⁸⁰ Boards may meet on a set schedule or as needed.¹⁸¹ The Chinese part-

172. Joint Venture Law art. 2.

173. Baxter, *Business with the People's Republic of China*, 5 CAN. BAR REV. 337, 355 (1979).

174. Wall St. J., *supra* note 1, at 30, col. 2.

175. Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 3.

176. Joint Venture Law art. 6

177. *Id.* Board interaction has received considerable attention in East European ventures in countries which require proportional representations. See generally, Jaslow, *Practical Consideration in Drafting a Joint Venture Agreement with China*, 31 AM. J. COMP. L. 209 (1983).

178. Joint Venture Law art. 6.

179. See, e.g., Wall St. J., June 20, 1983, at 3, col. 1 (noting R.J. Reynolds board with evenly split participation and representation).

180. See, e.g., *Electronics Joint Venture*, *supra* note 104, at 137 (Bishop Graphics' four member board and three vote majority in a four investor venture); *U.S. Firm's Deal*, *supra* note 146, at 89 (OMI Electroplating's four directors); Wall St. J., *supra* note 152, at 27, col. 1 (evenly split representation on oil joint venture boards as designated management committees).

181. See, e.g., *Electronics Joint Ventures*, *supra* note 104, at 137.

ners generally favor lengthy board consultations on relatively minor matters.¹⁸²

De facto power may frequently govern decisionmaking, regardless of membership or official leadership. Foreign partners usually hold superior informal powers in managerial ability and experience, technical skills, control of agreements to market the product abroad, and operations control in production, quality, or general management.¹⁸³ A shifting balance of de facto control can be stabilized and emphasized by agreements identifying particular areas of special authority.¹⁸⁴ Board structure may take into account such decisionmaking influences when acknowledged.¹⁸⁵

J. Setting Investment Share and Type

The Joint Venture Law allows up to one-hundred percent foreign ownership.¹⁸⁶ Most foreign partners provide technology in the form of equipment, training, or management.¹⁸⁷ Some also invest cash to implement joint venture plans.¹⁸⁸ A Chinese partner usually provides existing or new facilities, employees, and possibly low-level managers.¹⁸⁹ The Joint Venture Law requires the partners to determine an asset's value by joint assessment.¹⁹⁰ The technology of the foreign share must be truly advanced and appropriate to China's needs, or the foreign partner will be liable for enterprise losses.¹⁹¹

Foreign investors face a major dilemma when negotiating the value and protection of technology and other intangibles. Such protections are absent from Chinese business customs, under which an idea has no

182. One unprepared investor found the first board meeting lasted eight days. *See* Wall St. J., April 24, 1985, at 34, col. 4.

183. Jaslow, *supra* note 177, at 221-23.

184. *See e.g., JVs in China, supra* note 143, at 180 (AMC jeep board of directors' use of extensive by-laws to structure its functions, calling for broad initial foreign control despite AMC's minority position).

185. *See* Jaslow, *supra* note 177, at 221-23.

186. Joint Venture Law art. 4. Though possibly a wholly owned enterprise using Chinese facilities and labor should not be called a joint venture, it functions as one and joint venture tax laws may apply. *See, e.g., 3M's Venture Into China: Some Novel Features and Unanswered Questions*, BUS. INT'L, Dec. 23, 1983, at 401-02.

187. Joint Venture Law art. 5.

188. *See e.g., Wall St. J., supra* note 179, at 3, col. 1 (R. J. Reynolds invests cash and equipment). *But see, e.g., id.* at 18, col. 3 (Del Monte invests "very little money").

189. *See, e.g., Selling the China Market, supra* note 133, at 69 (China to supply all capital equipment for Clark Copier joint venture); *JVs in China, supra* note 143, at 180 (China to supply all buildings and tools for AMC jeep venture).

190. Joint Venture Law art. 5.

191. *Id.*

value.¹⁹² Recognizing that indifferent policies limited technology transfers and domestic incentives for creative achievements,¹⁹³ China implemented a Patent Law on April 1, 1985.¹⁹⁴ This law departs significantly from Maoist-Marxist ideology, but provides applicants only with limited protection. Seven categories of creative effort cannot be patented, including scientific discoveries, drugs, and foods.¹⁹⁵ The Patent Law, like many Chinese laws, succeeds only as a reassuring statement of policy.

The Chinese continue to be reluctant to pay for prototypes or other technology.¹⁹⁶ China's Trademark Law offers no real reassurance, since it fails to protect trademarks that directly indicate the product's specific characteristics.¹⁹⁷ In general, protections for intellectual rights fall below Western standards despite efforts to satisfy investors. Even if the law fully recognized intellectual property rights, the Chinese industrial structure works against technology protections. When the central government purchases technology in a joint venture contract, that knowledge theoretically becomes available to all of China.¹⁹⁸

Ongoing profit for the foreign investor usually lies not in protecting exclusive rights to processes and systems, but in supplying training for producers and services for consumers. Such a service orientation facilitates a successful technology transfer that depends on the end user's ability to use the technology.¹⁹⁹ High-tech firms have developed long-range strategies involving extensive service commitments to insure buyer satisfaction and a steady supply of new market contacts.²⁰⁰ Such a service and training plan may call for a formal agreement relating demand and

192. See Alford & Birenbaum, *supra* note 4, at 89-91.

193. *PRC's New Patent Law Will Protect Foreign Firms And Spur Local Inventors*, BUS. ASIA, March 30, 1984, at 97.

194. *Id.* See *supra* note 9. On April 1 Chinese and foreign businesses filed over 4000 patent applications. Wall St. J., April 3, 1985, at 34, col. 2.

195. *Id.* China will not grant patents for the following: scientific discoveries; rules and methods for mental activities; methods for the diagnosis or for the treatment of disease; food, beverages, and flavorings; pharmaceutical products and substances obtained by means of a chemical process; animal and plant varieties; and substances obtained by means of nuclear transformation. It will, however, allow processes used in producing certain products to be patented. The United States cannot provide effective protection despite more favorable terms in its Chinese trade agreements. *Id.*

196. See Alford & Birenbaum, *supra* note 4, at 89-91.

197. Moga, *supra* note 35, at 786-87. See *supra* note 9.

198. See Asian Wall St. J. Weekly, Nov. 15, 1984, at 15, col. 1.

199. *Export License Labyrinth*, *supra* note 29, at 285. See also *How High Tech Firms Plan to Service Products in China*, BUS. INT'L, Dec. 7, 1984, at 386-87 (Digital Equipment Corp.'s training sessions and self-teaching programs for computer users).

200. *Id.*

cost, but the value may be counted as a portion of joint venture investment.

V. ECONOMIC CONTROL AND FINANCE

A. Financing and Banking

Under the Joint Venture Law, a venture may obtain funds directly from foreign banks.²⁰¹ In fact, the Chinese Government prefers that ventures obtain financing from banks on their own merits. The Government has contributed the necessary funds for only a few joint ventures in crucial industries.²⁰²

A joint venture with government approval will nevertheless find ready financial aid, since many banks have entered the market since 1979. For example, the Government established the China Investment Bank in December 1981 to handle increasing business volume.²⁰³ Recently, the Bank of China enlarged its joint venture loan program.²⁰⁴ The Bank of America opened a branch in Beijing in February 1984 and another in Shanghai in October of the same year.²⁰⁵ Since the October reforms, Japanese banks have opened Chinese branches and have successfully offered foreign investment services to municipal governments.²⁰⁶

The joint venture may conduct most business with the bank of its choice.²⁰⁷ However, to repatriate profits it must register an open foreign exchange account with the Bank of China.²⁰⁸ The joint venture must generate sufficient foreign exchange credits to balance imports and domestic sales that generated profits for the foreign investor.²⁰⁹

In addition to the agreements on sources of initial financing, a joint venture contract may include agreements on additional financing sources for future needs. Otherwise, the initial investment and much goodwill may be lost over relatively small shortages which halt production or growth. The negotiators should consider which circumstances call for refinancing and which terms will be acceptable if refinancing is optional.

201. Joint Venture Law art. 8.

202. Comment, *supra* note 25, at 372.

203. *Id.*

204. *Id.*

205. Asian Wall St. J. Weekly, *supra* note 119, at 22, col. 4.

206. Asian Wall St. J. Weekly, Feb. 4, 1985, at 20, col. 1. For a review of available banks, ownership and services, see Baxter, *supra* note 173, at 357-58.

207. Joint Venture Law art. 8.

208. Joint Venture Law art. 10.

209. See *infra* notes 225-39 and accompanying text.

If profits fail to meet expectations, the partners may have great difficulty agreeing to increase the joint debts. The resultant strife may make a venture seem risky. For example, the Great Wall Hotel, a joint venture luxury hotel in Beijing, failed to generate profits on schedule because of construction delays and cost overruns. Disappointed partners blamed each other and haggled over allocation of costs, giving an impression of irreconcilable differences. As a result, thirteen of the fourteen banks holding overdue notes refused to refinance until the Bank of China agreed to allow all other creditors to collect before it required repayment.²¹⁰

B. Insurance

The joint venture must purchase insurance coverage from a Chinese insurance company.²¹¹ Insurance is a state enterprise and the lead entity is the People's Insurance Company of China (PICC).²¹² The PICC wrote only limited types of coverage until 1980, when it entered into cooperative arrangements with international underwriters.²¹³ Today, its rates and range of services are competitive with worldwide insurers.²¹⁴ The PICC has reciprocal claims agreements with four international firms and a joint venture with one of the four.²¹⁵

C. Profits, Tax, and Repatriation

In the profits, tax, and repatriation areas, the conflict between the Chinese national interest and the partners' individual interests cannot be effectively hidden. Current joint venturers complain that profits are diminished by a variety of government surcharges and frustrating repatriation procedures.²¹⁶ China's response is a significant indicator of China's purposes in foreign ventures.

The Joint Venture Law imposes foreign tax on gross income after deductions for worker benefits and reinvestment funds,²¹⁷ which foreign tax regulations impose only on net income after deduction of costs, ex-

210. Asian Wall St. J. Weekly, Dec. 3, 1984, at 3, col. 1.

211. Joint Venture Law art. 8.

212. Baxter, *supra* note 173, at 355.

213. *How To Arrange Insurance Coverage for PRC Ventures*, BUS. ASIA, Oct. 5, 1984, at 316. However, PICC may not provide the sophisticated coverage needed by oil or nuclear industries. *Id.*

214. *Id.* Coverage may include political risk insurance.

215. *Id.* at 317 (including specifics on purchase of coverage).

216. Wall St. J., *supra* note 1, at 30, col. 2.

217. Joint Venture Law art. 7.

penses, and losses.²¹⁸ The basic tax rate is thirty percent, but a ten percent local surtax increases the total to thirty-three percent.²¹⁹ China has structured such venture taxes to achieve government development goals. Few joint ventures pay the full one-third tax. Ventures with a ten-year operational life or low-profit operations (such as forestry or remote area development) can claim tax holiday benefits of up to five years.²²⁰

China cut tax rates in half for joint ventures investing in Special Economic Zones²²¹ or in energy, transport, or harbor facilities in the fourteen coastal cities.²²² Long term coastal projects may now also qualify for tax holidays.²²³ In addition, coastal joint ventures are exempt from many import duties on raw materials and equipment and from custom duties on all exports.²²⁴ It is doubtful that a foreign venture qualifying for tax breaks would receive government approval at all.

Although willing to reduce some taxes to attract partners with advanced technology, China appears unwilling to part with the foreign partner's profit share. Under the Law, joint venture partners distribute their profits in proportion to their capital contributions.²²⁵ However, the foreign partner's freedom to repatriate returns is severely restricted. Profits repatriated through the Bank of China decrease by ten percent above the standard thirty-three percent tax.²²⁶ Any domestic profits earned in foreign exchange units have been required approximately to balance foreign exchange disbursements paid from the venture's Bank of China account. However, an unfavorable foreign exchange rate greatly reduces domestic profits.²²⁷

A number of strategies can preserve some profits, but none represents a simple or satisfying solution. Taxed profits subsequently reinvested for five years in a joint venture provide a forty percent tax rebate

218. *Id.* See also Alford & Birenbaum, *supra* note 4, at 72.

219. See Alford & Birenbaum, *supra* note 4, at 72. The tax rate approximates income taxes required from Chinese entities. *Id.* It reflects a norm for LDC tax rates. Asian Wall St. J. Weekly, Dec. 7, 1984, at 10, col. 2.

220. Asian Wall St. J. Weekly, *supra* note 115, at 20.

221. *Id.* at 10.

222. Asian Wall St. J. Weekly, *supra* note 94, at col. 3. The ruling had a retroactive effect to Jan. 1, 1984. *Id.*

223. Asian Wall St. J. Weekly, Dec. 3, 1984, *supra* note 115, at 10.

224. Asian Wall St. J. Weekly, *supra* note 94, at 6, col. 3. Recently, the Government added a new 7% maintenance tax on all industry and commerce for city construction and renovation. Asian Wall St. J. Weekly, Jan. 28, 1985, at 20.

225. Joint Venture Law art. 7. See Comment, *supra* note 98, at 371. China's 1983 billion-dollar foreign exchange surplus sank to a \$900 million deficit in the first quarter of 1985 alone. Wall St. J., April 16, 1985, at 34, col. 4.

226. See *supra* notes 207-25 and accompanying text.

227. See Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 2.

to the investor on taxes paid.²²⁸ The investor may create another entity which earns exchange on the joint venture's behalf by marketing unrelated goods outside China²²⁹ or by buying and exporting Chinese goods.²³⁰ All such strategies except reinvestment result in some delay and loss, as the Government intends.²³¹

VI. LOCATION AND INFRASTRUCTURE

China has designated areas for concentrations of foreign investment. Ironically, these areas offer a better developed infrastructure because most were treaty ports under Western domination.²³² The Government offers tax advantages and bureaucratic streamlining to investors who choose to invest within one of these Special Economic Zones.²³³ The Government may deny any joint venture attempting to establish itself elsewhere.

Beijing initially chose four areas for experiments in capitalist business. Shenzhen, a 126 square-mile enclave adjacent to Hong Kong territory, developed most rapidly. Hong Kong investors provided more than ninety percent of new investment during the first year.²³⁴ The other zones—Zhutai, Shantau, and Xiamen—have developed more slowly.

In mid-1984, the Government announced through a set of regulations that it would also promote fourteen coastal cities as Special Economic Zones.²³⁵ Although authority of cities to contract without higher government approval varies, the regulations as applied to ongoing ven-

228. Alford & Birenbaum, *supra* note 4, at 75.

229. Alford & Birenbaum, *supra* note 4, at 100. Over the last two years the Government has allowed *renminbi* value to drop to increase exports. Wall St. J., Feb. 12, 1985, at 34, col. 1. Shenzhen may issue a freely convertible currency in 1986. Meanwhile, coastal ventures pay twice the official exchange rate for dollars. Asian Wall St. J. Weekly, Feb. 18, 1985, at 12, col. 1. As currency declined and its imports increased, China developed a trade deficit of \$890 million in the first quarter of 1985. Wall St. J., *supra* note 225, at 34, col. 4.

230. Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 3.

231. *Id.* See also *New Chinese Rules State How Sino-Foreign JVs Can Solve Forex Problems*, BUS. ASIA, Feb. 10, 1986, at 42 (strategies to solve foreign exchange problems).

232. *China Opens 14 Cities*, BUS. ASIA, April 13, 1984, at 115. The Government announced plans to open all coastal areas for foreign investment. Asian Wall St. J. Weekly, *supra* note 168, at 17, col. 1.

233. See *supra* notes 221-33 and accompanying text, and *supra* notes 147-49 and accompanying text.

234. Kraar, *supra* note 94, at 121.

235. *China Opens 14 Cities*, *supra* note 232, at 115. Shanghai and Dalian can approve projects for up to \$10 million without prior review by Beijing. Other cities can approve projects for up to \$5 million. *Incentives for Investors*, *supra* note 113, at 251-52. The average joint venture investment value is only \$2 million. Asian Wall St. J. Weekly, *supra* note 94, at 6, col. 3.

tures seem to be in accord with rules for the original four zones. Chongqing, in central China, has also served as a special laboratory to assess the effect of economic reforms on the agricultural population representative of eighty percent of China's citizens.²³⁶ A special zone has been isolated on the island of Hainan.²³⁷ The SEZs offer infrastructures for particular industries, in addition to bureaucratic advantages. For example, Dalian established a district specializing in electronics, precision instruments and meters, and metallurgical industries.²³⁸ Shanghai set aside one district for joint ventures and trading centers, and another for foreign office and living accommodations.²³⁹

Even these SEZs lack many amenities that are taken for granted throughout the West. Offices and telephones are usually difficult to secure. Beijing has a severe shortage of office space and foreign businesses must cope with ill-suited hotel accommodations at extremely high prices.²⁴⁰ Telephones are very expensive and scarce, with installation costing over \$1200.²⁴¹ Once installed, the telephone is less useful than its counterpart in the West, because the telecommunications infrastructure is inadequate to serve the vast country. Only one person in two hundred has telephone service.²⁴²

China's vast, inland natural resources may be entirely unavailable to a venture business located in a coastal location. China has no notable transport system; barges on waterways move the greatest volume of goods. Many roads are unpaved.²⁴³ The railways are overburdened and antiquated. Even the major ports are relatively shallow and so chronically congested that ships must often wait weeks or months for loading berths.²⁴⁴

236. See Wall St. J., *supra* note 114, at 36, col. 1.

237. See Asian Wall St. J. Weekly, *supra*, note 104, at 8, col. 2 (attracting investors to 14 cities and Hainan).

238. *Incentives for Investors*, *supra* note 113, at 251-52. *E.g.*, Natong plans to construct a deep water port; Beihai plans to process minerals for export by rail to the Port of Fanchong 100 kilometers to the west; Yantai plans ports, fish processing, textiles, and light industry. *Id.*

239. *Id.* Shanghai ranked first in output among Chinese cities in 1984. Asian Wall St. J. Weekly, *supra* note 229, at 13, col. 2. Although not designated an SEZ, Beijing's international status and access to high level approvals provide many of the benefits of an SEZ.

240. *Firms Must Hunt Hard and Pay Big Bucks for Offices in Beijing*, BUS. ASIA, Aug. 17, 1984, at 260-61.

241. *Id.*

242. Comment, *supra* note 25, at 379 (comparing a ratio of one phone to 1.4 people in the U.S.). *Id.*

243. See, *e.g.*, Kraar, *supra* note 94, at 121 (Pepsi bottling plant output faces a 19-mile truck journey through shifting mud whenever it rains). See also Wall St. J., *supra* note 110, at 34, col. 3. (Shanghai-Foxboro joint venture on traffic jammed mud road).

244. Comment, *supra* note 25, at 379. *E.g.*, plans to convert part of the port facility in

Energy sources for both production and transport are scarce. Rich coal deposits lie deep in the inland provinces.²⁴⁵ China's efforts to tap its oil resources have fallen short of expectations.²⁴⁶ The present oil supply is inadequate to support expansion of highway transport.²⁴⁷ In October 1984 the Government reported that twenty percent of the country's machinery stood idle because of energy shortages.²⁴⁸ The shortages were most serious in Shanghai, China's biggest industrial center, and in nine eastern provinces, including many SEZ port cities.²⁴⁹

The most advantageous site for a joint venture pairs the best physical conditions with the most capable and reliable partner available. That partner may already have reliable supply sources for closely related production and the ability to identify means for exporting new products. Such a partner may enable the joint venture to give first priority to Chinese producers as supply sources, as law requires.

VII. OPERATIONS MANAGEMENT

The Joint Venture Labor Regulations require that one of the investors serve as general manager.²⁵⁰ The requirement, however, is apparently not enforced if a salaried manager appears capable. Often, the existing staff supplies a factory manager, who may be an expatriate Chinese returning to China by government invitation. In the joint venture luxury hotels, managers are normally salaried Europeans.²⁵¹

One of the joint venture board's foremost tasks is the choice of a manager and the delegation of responsibility. The contract may include guidelines for selection and performance evaluation. Chinese managers require training in technical, budgetary, and personnel skills, while foreign managers may lack insight into Chinese customs and problems.²⁵²

Tianjin SEZ to a containerized shipping terminal cannot benefit surrounding areas because the highways and truck terminals are inadequate to handle a complementary volume. *Id.* at 379 (citing Suprowicz, *DOING BUSINESS WITH CHINA*, at 72 (1978)).

245. Comment, *supra* note 25, at 379.

246. Wall St. J. *supra* note 152, at 1, 27.

247. *Id.*

248. Asian Wall St. J. Weekly, Nov. 11, 1984 at 12, col. 3.

249. *Id.* Because of haphazard state allocations, poor transport, and erratic production, availability of supplies is uncertain. *E.g.*, while circuit boards are readily available, a small screw may be unavailable. Wall St. J., April 25, 1985, at 34, col. 4. Supply of workers is equally unpredictable. *Id.*

250. Joint Venture Labor Regulations art. 6.

251. *E.g.*, managers in the large hotels clearly have no substantial financial interests in those ventures. See Asian Wall St. J. Weekly, Jan. 14, 1985, at 17. One of the partners may select the management. See, *e.g.*, *U.S. Firm's Deal*, *supra* note 146, at 89 (OMI electroplating).

252. See Arnold, *supra* note 97, at 173.

If the industry calls for foreign management, individuals with a background of international contacts may handle the cross-cultural problems best. A survey of major hotels reveals operations managers are very often Europeans from the smaller nations of Belgium, England, and Switzerland.²⁵³

A. Personnel Management

Personnel management presents a complex problem in financial management and psychology for the contract negotiator and the operations manager. The Chinese acknowledge their lack of management skills and plan to solve pervasive management problems using Western techniques.²⁵⁴ China's productivity suffers from its tradition of iron-clad job security, exacerbated today by chronic overstaffing aimed at alleviating unemployment.²⁵⁵ Most of the available workers are entirely unskilled in modern production techniques.²⁵⁶ Wages remain low, despite increases from recent government orders and the twenty to fifty percent surcharge joint ventures must pay.²⁵⁷ Workers receive less than one-fourth of the surcharge, the balance going to the Government.²⁵⁸ As a result of such difficult, static conditions, worker output is low, morale is poor, and absenteeism is high.²⁵⁹

An investor and manager can anticipate these problems at the venture's negotiation stages. The joint venture labor contract must address employment and dismissal rights.²⁶⁰ The investor should bargain for the right to set aptitude standards by defining the extent of training the venture will provide. Costs of these training obligations justify limiting the amount of excess staff the venture will be pressed to accept.²⁶¹ Labor regulations allow dismissal of workers who fail at training or "surplus" workers.²⁶² The contract should reserve the right to fire unproductive workers by defining these terms. The standard for a successfully trained

253. *What to Watch*, *supra* note 112, at 299.

254. *See Asian Wall St. J. Weekly*, *supra* note 168, at 17.

255. *See Alford & Birenbaum*, *supra* note 4, at 85.

256. *See Arnold*, *supra* note 97, at 173.

257. *See Export License Labyrinth: A Chinese Puzzle for High Tech Sales to PRC*, *supra* note 29, at 386.

258. *See Alford & Birenbaum*, *supra* note 4, at 79. Chinese wages equal 50-75% of pay scales in developed countries. *See Comment*, *supra* note 25, at 374.

259. *See Asian Wall St. J. Weekly*, *supra* note 94, at 6, col. 2.

260. Joint Venture Labor Regulations art. 3.

261. *What to Watch*, *supra* note 112, at 299.

262. Joint Venture Labor Regulations art. 11.

worker should require a cooperative attitude, allowing managers to fire those workers with chronic morale problems.

Despite such precautions, investors find their control of personnel extremely limited.²⁶³ As a result, most personnel management problems involve long-term morale and staff development issues. A Western manager should avoid confusion and dissatisfaction by adopting Chinese work patterns to the extent that they do not impede production.

In most Chinese factories, workers put in a twelve-hour day between 8:00 A.M. and 8:00 P.M. A large midday meal with a two hour rest break begins around noon. Workers with families in other provinces return home for approximately a month, either by rotating duty, or by plant closure.²⁶⁴ An annual leave remains especially appropriate for skilled workers who leave their provinces and families to work on a joint venture project.

The joint venture must provide other benefits similar to those the Government provides all workers.²⁶⁵ The Joint Venture Labor Regulations require payment of labor insurance, medical expenses, and additional subsidies.²⁶⁶ The Government normally provides day care, education benefits, retirement pay, and generous support during pregnancy or disability. The type and extent of benefits offered by the venture are negotiable and may be negotiated to yield maximum worker satisfaction at reasonable cost.

The problems of worker morale may be addressed in a number of ways. The training mentioned above may boost worker self-esteem.²⁶⁷ The venture may also be permitted to offer bonus payments, which clearly motivate Chinese workers.²⁶⁸ In rural economic experiments, farm workers produced record crops to earn "bonus" income from sales in the free markets.²⁶⁹ The Government's short-lived bonus program fell prey to corruption that the joint venture may succeed in avoiding.

Bonus payments should be tied to the venture's location and resources. One joint venture pays ten percent of wages in foreign exchange, so workers can buy goods in the well-stocked foreign exchange

263. Wall St. J., *supra* note 1, at 1.

264. See Kraar, *supra* note 101, at 124, 128.

265. Joint Venture Labor Regulations art. 9.

266. *Id.*

267. Comment, *supra* note 25, at 376.

268. See, e.g., *How High Tech Firms Plan to Service Products in China*, *supra* note 199, at 386.

269. Reeder, *supra* note 15, at 75-76.

shops.²⁷⁰ Bonuses in venture stock have not yet been approved, but may be in the future.

The joint venture structure benefits by creating an environment that satisfies the Chinese workers' emphasis on group identification. To guide planning toward that end, an investor should consider the trend toward the work group identification in the West.²⁷¹ Innovative businesses have attempted to increase productivity by using "quality circles" of coworkers who practice mutual, corrective criticism.²⁷² The Chinese fervor for group identity inhibits individual innovation. Workers generally avoid distinguishing themselves by innovative suggestion or unusual achievement.²⁷³ Careful blending of Chinese and Western management styles has the potential to maximize productivity.²⁷⁴

A final personnel issue involves arrangements for Western workers employed in China. These workers require housing, food, education, and medical services far superior to those available to Chinese workers. Typical Chinese urban housing is quite cramped and many units lack bathing facilities.²⁷⁵ Furthermore, the Government may limit utilities, including heat.²⁷⁶ Generally, the Chinese Government prefers to segregate Western visitors and has identified communities for their use. This segregation tends to reduce comparisons between Chinese and visitors' living conditions. However, a conspicuously privileged foreign class may evoke Chinese memories of domination.²⁷⁷ An investor who is aware of the tension created by such problems should be better able to assess available housing.

B. Accounting

The tax regulations include basic formulas for computing taxable income, specific allowable deductions, depreciation of fixed assets, calendar year, and accounting methods.²⁷⁸ These regulations are supplemented by the Accounting Regulations of the People's Republic of China

270. *Id.* The free market has goods that the Chinese could not get two years ago, but most sought-after Western products still sell only in foreign exchange outlets.

271. See *supra* notes 75-79 and accompanying text. Bonuses, wages, honorable titles, skill, and promotion tend to motivate workers, in that order. Nevis, *supra* note 75, at 23.

272. *Forum—The Productivity Challenge: A Far Broader Approach is Necessary*, N.Y. Times, Feb. 17, 1985, at F3, col. 1.

273. See Arnold, *supra* note 97, at 173; Wall St. J., *supra* note 107, at 34, col. 4.

274. *Id.*

275. Alford & Birenbaum, *supra* note 4, at 92.

276. Beijing customarily saves fuel by cutting off residential heating on March 15, although temperatures may drop to 40 degrees in April. Wall St. J., Feb. 15, 1985 at 27, col. 5.

277. *Id.*

278. Alford & Birenbaum, *supra* note 4, at 92.

for Joint Ventures Using Chinese and Foreign Investment, which became effective July 1, 1985.²⁷⁹ The rules generally follow international accounting practices, with some unusual rules and limitations.²⁸⁰ The joint venture must keep all accounting records in the Chinese language to allow audit by tax authorities.²⁸¹ It must keep a standard balance sheet, income statements, and a statement of changes in financial position.²⁸² Infractions may be prosecuted in the People's Economic Courts.²⁸³

Although China has a shortage of certified public accountants, foreign accountants cannot formally register. The foreign partner may, however, conduct an independent audit at its own expense, and may have a foreign accountant participate in a joint audit.²⁸⁴

The Chinese concept of accounting is evolving slowly toward the Western concept. Many issues, including adjustments for multiple taxation, or strategies for passing the tax burden on to consumers in the nonmarket economy, are not yet resolved.²⁸⁵ A joint venture negotiator loses nothing by structuring accounting in order to take advantage of the many ambiguities, but should remember that China still views business as a source of government revenues.²⁸⁶

C. Quality Control

Theoretically, the joint venture's Chinese workers should be able to produce consistently high quality goods in most industries. Chinese purchasers require strict quality assurances and opportunities to inspect incoming goods.²⁸⁷ However, buyers have found that even premium goods are uneven in quality. To some extent nonindustrial Chinese culture lacks rigorous standards of uniformity typical of Western industrial production methods. For example, a recent edition of the *Beijing Economic* newspaper contained many errors, including the date of publication.²⁸⁸

Other causes of poor quality may be managed, however. Worker indifference may be minimized by methods discussed above.²⁸⁹ Inferior

279. *Id.*

280. *Id.*

281. *New Chinese Rules Set Accounting Standards for Joint Ventures*, BUS. ASIA, July 19, 1985, at 231 [hereinafter *New Chinese Rules*].

282. *See id.* *See also* Comment, *supra* note 25, at 364-68.

283. *New Chinese Rules*, *supra* note 281, at 231.

284. *See* Alford & Birenbaum, *supra* note 4, at 74-77.

285. *New Chinese Rules*, *supra* note 281, at 231.

286. *Id.*; Alford & Birenbaum, *supra* note 4, at 88.

287. Comment, *supra* note 25, at 368.

288. Alford & Birenbaum, *supra* note 4, at 85.

289. *See* Wall St. J., Feb. 26, 1985, at 38, col. 1.

equipment and outmoded production techniques may be replaced by modern technology. Perhaps most importantly, personnel training can explain the product's function so the worker can recognize adequate and superior quality.

Foreign managers report that Chinese workers are very willing to comply with a positive model.²⁹⁰ The contract might require that the product match its Western counterpart in every significant detail, achieved by using methods and objective specifications observed in existing Chinese productions. Such positive contract provisions for production modification may provide the groundwork for cooperation and avoid resentment and blame over unmarketable early products.

D. Marketing, Pricing, and Advertising

Most investors who choose China rather than another undeveloped country want a share of the world's largest consumer market.²⁹¹ Altering early policies to attract investors, the Government now allows joint venturers to negotiate for access to domestic markets.²⁹² Investors complain, however, that such promises of market access remain unfulfilled.²⁹³ Producers find they cannot sell the negotiated percentage of their products because trading associations refuse to buy,²⁹⁴ probably on government instruction. The Government is most likely to permit joint ventures to sell high technology or other short supply items.²⁹⁵ To locate a ready market, a joint venture entity should plan sales of improved products to customers who were formerly served by its Chinese partner.²⁹⁶

The pricing of joint venture products presents special problems at a time when the Government is attempting to deregulate prices after decades of stringent controls. Dramatic price increases are keyed to wage increases.²⁹⁷ To cope with rapidly changing conditions the joint venture should reserve the right to set domestic market prices according to sup-

290. See *supra* notes 261-72 and accompanying text.

291. Asian Wall St. J. Weekly, *supra* note 251, at 16, col. 3.

292. See Comment, *supra* note 25, at 381; *supra* notes 25-28 and accompanying text.

293. Until 1982, the China Government required that exports of joint venture goods must match any domestic sales, and otherwise strictly limited access to domestic markets. Fewer than 50 investors formed joint ventures. Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 2.

294. Wall St. J., *supra* note 1, at 30, col. 2; Asian Wall St. J. Weekly, Oct. 15, 1984, at 15, col. 2.

295. Asian Wall St. J. Weekly, *supra* note 115, at 24, col. 2.

296. Asian Wall St. J. Weekly, *supra* note 94, at 6, col. 3.

297. See, e.g., Wall St. J., Mar. 21, 1985, at 34, col. 3.

ply and labor costs. Formulas used to set prices on the world market may serve as a model.

Aside from securing an opportunity to sell and setting a reasonable price, few ventures have actively promoted their products. Advertising is rare in China, since state-owned enterprises have no cause to offer incentives to consumers to buy their scarce commodities. One Western firm has used billboard messages to encourage readers to buy out of provincial loyalty, a strong Chinese tradition.²⁹⁸ Several joint ventures are now analyzing the Chinese market for other advertising and marketing techniques.²⁹⁹

The advent of Western television in China promises that advertising will soon be commonplace. A study of government slogan campaigns might suggest strategies for use there. Commercial slogans may be geared to the unusual Chinese market characteristics: the average age, twenty-six, is the youngest in the world, and half the Chinese population is under twenty.³⁰⁰

The joint venture is free to market its products outside China.³⁰¹ Planning for world markets primarily involves problems in quality control and transportation.³⁰² The foreign partner can avoid competing with its own subsidiaries outside China by specifying in the contract that its Chinese products must be sold on other, noncompeting markets.

VIII. CONCLUSION

Investors have difficulty deciding whether to take advantage of their China venture possibilities. According to government objectives, China's peasant society will embrace consumerism and light industry within five to fifteen years. Undeniably, the transition has begun, and a consumer lifestyle compatible with Chinese traditions is developing. Yet, the more the economy changes, the more closely tied to its traditional values China seems to become. These values have never encompassed capitalism and may ultimately hamper China's enthusiasm for business as Western investors would like to see it conducted.

The economic indicators delivered confusing messages. In 1985

298. See Wall St. J., *supra* note 134, at 34, col. 1; Asian Wall St. J. Weekly, *supra* note 229, at 12, col. 1.

299. See, e.g., Comment, *supra* note 25, at 381-82.

300. CBS recently began television advertising in China for IBM, Boeing, Kodak, Proctor and Gamble, and Weyerhaeuser. Asian Wall St. J. Weekly, Jan. 28, 1985, at 20, col. 4. See also Comment, *supra* note 25, at 381.

301. Joint Venture Labor Regulations art. 9.

302. See *supra* notes 248-67 and accompanying text.

China experienced soaring inflation, high trade deficits, and depleted foreign exchange reserves,³⁰³ contrasting with a remarkable growth rate in the private sector for both light and heavy industry.³⁰⁴ The figures suggest strong continued support for private industry, but hint of tighter foreign trade controls.³⁰⁵ The Seventh Five-Year Plan for 1986-1990 projects an overall seven percent growth rate.³⁰⁶ Price deregulation may be the most immediately vulnerable point. Though the Government prevented hardships by raising salaries before raising prices, it could not prevent consumers from anticipating price increases. Consumers in each city emptied market shelves on the final day of the old price structure. Under the new structure, prices rose an average of more than fifty percent.³⁰⁷

Political reshuffling under Deng's control makes sudden policy reversals less likely than those experienced in the past.³⁰⁸ Deng's protégés, Hu Yaobang and Zhao Ziyang, probably have enough power and expertise to maintain a reasonably successful policy as a growing number of ministries come under the authority of reform supporters.³⁰⁹

Indicators of new lifestyles reach the press almost daily, and reform becomes more difficult to reverse as its effects become complex and pervasive. Chinese workers have begun to think enthusiastically of their consumer power,³¹⁰ and the government has permitted credit sales for the first time since 1949 to encourage purchasing.³¹¹ A new market in ideas and art has gained vitality. China Central Television brings audiences carefully chosen Western presentations.³¹² The Government now

303. *PRC Economic Reforms*, *supra* note 12, at 129-30.

304. *PRC Economic Data Reveal Boom Conditions as Well as Dismal Trends*, *BUS. ASIA*, March 24, 1986, at 89.

305. *China in 1985 Records Huge Trade Deficit, Healthy Output Growth*, *BUS. ASIA*, Jan. 27, 1986, at 307.

306. *Id.*

307. *See, e.g.*, *WALL ST. J.*, May 10, 1985, at 29. col. 1; *Asian Wall St. J. Weekly*, *supra* note 22.

308. China's Party Conference, *supra* note 45, at 308.

309. *See id.* at 307-08. However, the Ministry of Foreign Economic Relations and Trade recentralized control of steel, chemical fertilizer, grain, and sugar, and Beijing central government reclaimed control of crude oil, coke, grain, and cotton, because "incompetent and redundant" local authorities concluded disadvantageous deals. The SEZs retained their delegated authority. *Id.* at 130.

310. Retail sales rose 17.4% in 1985. *Asian Wall St. J. Weekly*, Jan. 28, 1985, at 20, col. 2. *E.g.*, the Chinese now want to acquire color television sets. *Asian Wall St. J. Weekly*, Feb. 18, 1985, at 12, col. 4. High-heeled boots are fashionable and counterfeit Western blue jeans have replaced drab uniforms. *Id.*

311. *Asian Wall St. J. Weekly*, *supra* note 300, at 20, col. 4.

312. *Id.* The Chinese chose "Muggable Mary," a cancelled network series about a woman

even permits Western music and dancing as part of quasi-political holiday celebrations.³¹³ Christian evangelist Billy Graham accepted China's invitation for a 1986 tour of fourteen universities.³¹⁴ In a revitalization of arts and ideas, the Government has permitted performances of traditional opera,³¹⁵ and has encouraged some literary innovation.³¹⁶

Although China's crippling lack of industrial infrastructure presently shows little improvement, specific areas are developing to meet the need of particular industries. The new Five-Year Plan narrows these preferred industries to include energy, transport, telecommunications, and industrial raw materials. Power generation capacity is planned to increase forty-seven percent in five years, and freight transport capacity thirty percent.³¹⁷

China continues to attract Westerners as would-be investors. Some never complete negotiations, some lose their initial investments³¹⁸ and leave frustrated and angry.³¹⁹ All Western investors discover unanticipated problems.³²⁰ Those who apparently succeed have adopted an optimistic attitude drawing on the spirit of China itself.³²¹ In sum, China is poor, underdeveloped, plagued with shifting priorities, and inexperienced in business. It is most certainly not Westernized and, despite its new trappings, will remain steeped in its cultural heritage. But with extensive planning and great patience, it may prove a richly rewarding arena for investment.

police decoy; "Quarterback Princess" a TV movie about a girl who tries out for a high school football team; and some football games. *Id.*

313. See Miami Herald, May 2, 1985, at 22A, col. 1.

314. Miami Herald, Feb. 14, 1985, at 1, col. 6.

315. See Asian Wall St. J. Weekly, *supra* note 229, at 12, col. 4.

316. Salisbury, *On the Literary Road: American Writers in China*, N.Y. Times Book Review, Jan. 20, 1985, at 3. Chinese writers were brutally suppressed during the Cultural Revolution. *Id.*

317. *China's Party Conference*, *supra* note 45, at 308.

318. See, e.g., *Electronics Joint Venture*, *supra* note 104, at 68 (Clark Copiers joint venture underfunded and stalled).

319. See, e.g., Asian Wall St. J. Weekly, *supra* note 20, at 2, col. 1 (Australian hat manufacturing joint venture ends in bitter recriminations by each partner).

320. See, e.g., Wall St. J., *supra* note 107, at 34, col. 2.

321. See Asian Wall St. J. Weekly, *supra* note 189, col. 1.